

## The Certainty of Change

by Pat Byrnes

Stock prices are up... *No, down.* Unemployment rates are low... *No, huge layoffs are going on all around us.* The economic outlook is good... *No, or is it Yes?*

In the midst of all this change and uncertainty, one thing is clear: As a society, we are shifting from a manufacturing/capital-intensive environment to a knowledge-driven human capital environment. When businesses lay off employees, they are simultaneously looking for ways to retain their best people. Layoffs effectively create a greater need for organizations to hold onto their intellectual capital.

Many companies are struggling to develop a contemporary human resources philosophy and strategy. They are shifting from hourly and base salary work environments to settings where each employee has a compensation and benefits package that includes base compensation, performance-based incentives and benefits, all of which are supported by a strong culture.

ACI has not remained static throughout this time of change. We, too, have been investing heavily in our human capital. We now help our clients develop human resource philosophies and strategies that are supported by performance-driven compensation and benefit programs which, in turn, are in line with businesses' strategies and the cultures they seek to develop.

Even our logo has changed. Although it is very similar, we have flipped it and turned it in a new direction. This reflects the new direction in which ACI is headed. We have evolved into a benefits consulting firm with broad expertise in all facets of compensation and qualified retirement plans. Our clients benefit from our new perspective and unique approach to employee attraction and retention.

We continue to provide stellar qualified plan and cafeteria plan consulting and administration services. You will also begin to see an evolution in our partnering with clients as we help them meet their changing corporate and employee benefit needs.

The future, as always, remains uncertain. We are committed, though, to remaining true to the values that have made ACI successful and to fulfilling our vision: To transform the lives of our clients and their employees by changing their experience of work.

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# New Minimum Distribution Rules: A Welcome Improvement

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by Bob Eastwood

*The Treasury Department recently caught the financial community by surprise when they released substantially revised proposed minimum distribution rules. The new rules, slated to be mandatory in 2002 and optional for 2001, greatly simplify required distributions for retirement plan participants and IRA owners age 70½ or older.*

## Why Minimum Distributions?

Minimum distributions were added to the tax code to generate income tax revenue for the US Government. The reasoning goes pretty much as follows: the Government has given the IRA owner and retirement plan participant substantial tax advantages during their working years while they accumulate retirement funds. By the time a worker retires and is over age 70½, or the IRA owner reaches age 70½, it's payback time for Uncle Sam. Thus, retired workers with company retirement plan benefits, and IRA owners over 70½, *must* begin to receive taxable income from their retirement funds.

## Minimums Will Usually Be Lower

For the most part, mandatory payments after age 70½ will be lower and will rarely be higher than those required by the new rules' 1987 predecessor. In some cases, the reduction can be 50% or more. Because these rules mandate *minimum* taxable distributions (larger distributions can usually be arranged) the smaller the minimum, the better.

## Revenue Winner or Loser?

Along with reducing and greatly simplifying required distributions, the Treasury Department intends to require retirement plans and IRA trustees to report required minimum payments. The penalty for non-receipt equals 50% of any missed minimum payment and must be paid by the individual who was due to receive the distribution. Thus, while the new rules may reduce an individual's required taxable income by 20% or more, the penalties associated with non-reporting will probably result in an overall increase in income reported to the IRS, resulting in a net gain. In other words, the new penalties will "encourage" people who have historically failed to report required distributions as taxable income to comply with the law.

## Is Simpler Really Better?

In addition to greatly simplifying the calculation process, the new rules substantially reduce available options for the recipient of the payment. For example, the old rules made the calculation of minimum payments largely dependent upon who was initially selected as a beneficiary. Furthermore, the benefit recipient could decide whether to recalculate life expectancies each year or simply reduce the previous year's expectancy by one. Life expectancies are divided into the account balance to determine the minimum distribution. The combination of various possible beneficiaries with varying lifetimes, along with the recalculation vs. "reduce by one" option, provided a variety of payment options.

The new rules usually provide the same "distribution period" for living plan participants or IRA holders, regardless of the age of the beneficiary. Furthermore, the "recalculation option" for life expectancies has been eliminated. These simplifications greatly reduce the number of options available to those approaching age 70½. Under the new rules, you can still decide whether to take your first distribution in the year you reach age 70½ or wait until the next April 1 – which results in two taxable distributions during that tax year. Selection of a beneficiary has no impact on the minimum payment the participant receives during his or her lifetime, so the selection can be made simply on the grounds of who should receive the money after the participant's death.

## New Rules Have Flexible Effective Date

Taxpayers who wish to use the new rules for the payment due in 2001 may do so, but use of the old rules is still permitted. The new rules will be mandatory for 2002 payments. While retirement plans are permitted to be amended so that 2001 payments will be calculated under the new rules, they *are not* required to do so. This creates an issue for plan participants who would ordinarily prefer a smaller taxable payment under the new rules. The problem can be resolved, however, through the use of a rollover.

For example, suppose your retirement plan pays you a \$10,000 minimum payment in 2001 based on the old rules. Had they used the new rules, the payment would be \$7,000. You have 60 days after receiving the \$10,000 to roll over as much as \$3,000 to an IRA or another retirement plan, thus postponing income tax on the rollover.

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*See "Distribution Rules" on page 6*

# 401(k) Salary Deferrals: Timing Is Everything

by Jeff Wallace

## *DOL Investigations Focusing on Timing of Deferral Deposits*

During recent investigations of 401(k) plans, the Department of Labor (DOL) has focused on an issue that is sometimes overlooked by plan sponsors: The timing of salary deferral deposits into 401(k) plans. These investigations, conducted by the Pension Welfare and Benefits Administration (PWBA) of the DOL, require close coordination between the plan sponsor, the plan administrator, and ERISA counsel.

### **When must 401(k) deferrals be deposited?**

According to ERISA Reg. §2510.3-102(a), amounts that a participant has withheld from wages for contributions to a qualified retirement plan are plan assets as of *the earliest date on which the contributions can be reasonably segregated from the employer's general assets*. However, under no circumstances may this process take longer than the 15<sup>th</sup> business day of the month following the month in which the withholding occurred. It is important to note that the DOL does not consider

the 15-day period to be a safe harbor. An employer must still contribute a participant's elective deferrals to the plan by the earliest date possible.

For example, if an employer *typically* issues a 401(k) deferral check to the plan trust within three days of each payday, according to the DOL, the employer can be reasonably expected to transmit deferrals within three days of *every* payday. Deferral deposits that occur after this three-day period are considered to be late deposits.

### **What happens if a deposit is late?**

If the employer misses a deadline, the money is deemed to be a plan asset. Since the asset is held by the employer instead of the trustee, a "prohibited transaction" occurs, resulting in a 15% excise tax. The tax continues at an annual rate of 15% until the money is paid into the trust. When the employer eventually deposits the late deferrals, earnings must also be added to the deposit in order to compensate participants for the delay.

The DOL has also taken the position that if the delay is deliberate and long lasting, the employer may face civil and/or criminal penalties.

### **How can you avoid late 401(k) deferral deposits?**

The simplest thing an employer can do to avoid late deposits is to establish a procedure that the organization's accounting and/or human resources staff members follow each pay period. The procedure should consist of a series of written guidelines clearly conveying who is responsible for confirming the deferral amount, preparing the deferral check, and submitting the check (or authorizing the wire transfer) to the trust. It may also be advisable to track the actual deposit date, not simply the *transmittal* date. In the event that a DOL audit uncovers delays in deposits to a 401(k) trust, the employer may mitigate penalties by demonstrating that the funds were sent / transferred within the "reasonable" time period.

If you have questions about 401(k) deferral deposits, please contact an ACI consultant or administrator.

## Work / Life Benefits Growing in Popularity

Employees' expectations of "the work experience" have changed over the last several years. As employers continue to focus on attracting and retaining great people, they are incorporating an expanding lineup of Work/Life benefits.

According to the 2001 Benefits Survey by the Society of Human Resource Management, benefit

programs that have increased over the last five years include:

- Retirement & Financial Planning
- Paid Time Off Plans
- Domestic Partner Benefits
- Flexible Scheduling

The SHRM Survey also revealed that the number of employers offering

telecommuting rose from 20% in 1997 to 37% in 2001, and flextime benefits increased 58% between 2000 and 2001. Also on the rise are compressed workweeks (9 days / 80 hours) and job sharing.

Other benefits noted in the Survey: 69% of employers offer flexible spending accounts, while 46% offered employees long-term care insurance.

# Investing in Volatile Markets: What to Do When You're Scared

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Submitted by Bambi Holzer

*The following basic investment principles are as valid today as when I first wrote them—when the market was flying high and everyone was in love with stocks*

Federal Reserve Board Chairman Alan Greenspan is famous for the term “irrational exuberance” which he used to describe the stock market in December of 1996. Shortly after he made his remarks, I wrote an article titled “How to Keep Your Head During Exuberant Markets” which outlined four key strategies designed to help investors keep from getting carried away by the frenzy in the markets. My point (and his) was that investors were becoming overly optimistic and throwing caution to the winds. They were ignoring tried-and-true investing principles in the interest of making a quick buck in the market. Much to our consternation, they went on to enjoy above-average investment returns for three more years before the bottom fell out of the market in March of 2000.

Now, of course, the mood is quite different. Stocks have continued their year-long slide and exuberance, irrational or otherwise, is completely missing from today's market. Given how quickly things can change, I thought I would go back and revisit the article I wrote when the stock market seemed to go in only one direction (up) and people were clamoring to get into risky stocks at any price. Guess what I found? Nothing's changed! The four points I presented three years ago are as valid today as ever. The only thing that's changed are the explanations

since the mood has switched from greed to fear and investors today need encouragement, not restraint. The coping mechanism hasn't changed, however. Indeed, this non-emotional approach to investing is just what's called for when you're scared.

## 1. Know your risk tolerance

When the market was going up, people used to tell me they had a high tolerance for risk. “Sure, we don't mind losing money if it gives us an opportunity to earn higher than average returns,” they would tell me. The problem was that they didn't really understand the concept of risk because they'd never experienced it before (and didn't really think it would happen). Now that they've seen how bad the stock market can be, they have a more balanced view of risk and can more accurately answer the following questions:

### *The fear versus greed factor*

Which would bother you most: being in stocks when the market is going down or being out of stocks when the market is going up?

### *The pit of your stomach factor*

How much can you stand for your portfolio to lose in a single year? Less than 5%? 5-15%? More than 15%?

### *The patience factor*

How long do you plan to leave the money invested? Less than 5 years? 5-20 years? More than 20 years? The longer you plan to leave the money invested the more risk you can assume since you'll have time to ride out interim fluctuations.

## 2. Diversify your portfolio

The theory behind diversification is that when some markets are moving down others are moving up. And since you can never be sure which ones will do what, you invest a cross section of your portfolio in each of several categories.

### *Diversify across asset classes*

The most basic form of diversification is to put some money in stocks, some in bonds, and some in cash. The higher your risk tolerance, the more you can put into stocks.

### *Diversify across sectors*

When technology stocks are suffering, basic industry may be doing well. Same goes for large cap stocks versus small cap stocks, U.S. stocks versus foreign stocks, “growth” stocks versus “value” stocks, and so on. Again, the higher your risk tolerance the less you need to diversify. Since diversification can dilute performance, some aggressive investors like to place their bets and face the consequences if they're wrong. This is fine as long as you know what you're doing. If not, invest in a cross section of mutual funds and let the markets do what they will.

## 3. Periodically rebalance your portfolio

Market movements can cause the best laid plans to get out of whack. Let's say your risk tolerance is moderate so you decide to allocate your assets as follows: 60% stocks, 30% bonds, 10% cash. A year later, your stocks have dropped so they now represent 50% of your total portfolio. Although it would be tempting to dump all your stocks and hide in a money market fund, what's called for here is the counter-intuitive strategy of buy-

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*See “Investing” on page 6*

# The Annual Retirement Plan Audit: Limited-Scope vs. Full-Scope

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Submitted by Jenny Bolsky and Jeffrey Goss

If you have over 100 participants in your retirement plan, an audit of your plan by an accountant is required. There are two type of retirement plan audits: Limited-Scope and Full-Scope. The Employee Retirement Income Security Act of 1974 (ERISA) allows a plan administrator, generally the employer/plan sponsor, to authorize the plan's auditors to perform a "limited-scope" audit in accordance with the Department of Labor's (DOL) Rules and Regulations for Reporting and Disclosure under ERISA.

The limited-scope audit not only saves the auditors time, it can also save the employer / plan sponsor audit fees (related to both the accounting firm and the plan administrator). The limited-scope exemption does not exempt the plan from the requirement to have an audit; it does, however, limit the amount of testing required on the plan's investment information if the following criteria are met:

- The trustee or custodian prepares the information regarding investment assets and transactions and certifies its accuracy and completeness. (This certification should not be confused with the "Report on Internal Controls" that often accompanies trustee statements.)
- The trustee or custodian is regulated, supervised, and subject to periodic examination by a state or federal agency (generally a bank, trust company or insurance company—the limited-scope provision does not apply to investments held by a broker/dealer or an investment company)

The limited-scope exemption applies only to investment information, and does not extend to benefit payments, for example, even if certified by the trustee or custodian. The auditor's only responsibilities for investment assets held and transactions executed in a limited-scope audit include the following:

- Comparing the information certified by the trustee or custodian to financial information contained in the plan's financial statements
- Further investigation and testing if the auditor becomes aware that the information certified is incorrect, incomplete, or otherwise unsatisfactory for financial reporting purposes

Audit procedures required by a full-scope audit in accordance with generally accepted auditing standards that may be omitted from a limited-scope audit are as follows:

- Obtaining an understanding of internal control related to investment assets held and transactions executed at the certifying institution
- Assessing control risk for investment assets held and transactions executed at the certifying institution
- Examining and reporting on investment assets held and transactions executed at the certifying institution

Audit procedures for all non-investment-related information are the same for a limited-scope audit as for a full-scope audit.

In some cases, only a portion of a plan's investments may be covered by the certification of a qualified trustee or custodian. If these covered investments are significant to the plan's financial statements taken as a whole, and are not audited, a limit-scope audit report is required.

It should be noted that the Securities and Exchange Commission will not accept a limited-scope audit report in connection with a Form 11-K filing, even if the plan has elected to file financial statements that are prepared in accordance with the financial reporting requirements of ERISA.

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ing even more stocks to bring your overall stock allocation back up to 60%. Three years ago I was telling people to sell some of their stocks because their stock allocation had become too high. They thought I was crazy then, too. One of the main benefits of portfolio rebalancing is that it forces you to ignore the emotionalism of the markets and stick to a strategy developed when you had a clear head.

#### **4. Keep adding new money**

Putting money into the market at various times is a form of diversification too. Since you can never know the exact right time to invest in the market, you invest at lots of different times. When you do this, you actually want the market to go down because then you get more shares for your money. This is commonly known as dollar cost averaging. A program of systematic investing ensures your participation and keeps you from having to ask, "Is this the right time to buy?"

**Bambi Holzer** is Senior Vice President – Investments and a retirement planning consultant with UBS/PaineWebber. She is the author of two books on retirement planning: *Set for Life: Financial Peace for People over 50* and *Retire Rich: The Baby Boomer's Guide to a Secure Future* (John Wiley & Sons).

## **ACI on the Web**

*www.acibenefits.com*

ACI's website will be online June 1. The site, which we expect to evolve into an important resource for ACI's clients and their advisors, will have two components: A general information site and a secured site.

The general information site will provide the public with information about ACI and resource material related to employee compensation and benefit programs. It is essentially an enhanced version of an electronic brochure.

The more powerful component of the web site is the secured site, which will include individual home pages for selected clients. Among the information available on these home pages will be plan documentation and communication material, administrative forms and reports, contact information for ACI staff members, as well as other advisors, links to investment providers, and a private library of news articles and legislative updates tailored to each client's plan.

We are looking for five clients interested in being members of a pilot group to develop secured home pages for their organizations. If interested in participating, please contact Jeff Wallace at extension 138.

## **New Rules Are Better**

The new rules reduce mandatory taxable distributions in most cases and rarely result in distribution increases. Their simplicity comes as a welcome relief to all but the most serious financial strategists. The fact that they facilitate government reporting should mean higher tax revenues by simply increasing the number of individuals who comply. We applaud the Treasury officials responsible for these regulations. They represent a step in simplifying an enormously complicated retirement income tax structure.

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## **Coming Soon: Cafeteria Plan Inquiries via the Web**

*ACI is significantly enhancing our Cafeteria Plan services!*

Beginning September 1, clients who sponsor cafeteria plans will be able to provide their participants with access to cafeteria plan information, including account balances and claim information, via the Internet.

We expect this new service to streamline the inquiry process, simplifying the lives of our clients' human resources staff members.

For more information regarding these services, contact Monique Seelig or Jeff Wallace.

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